

1 **DIRECT TESTIMONY**  
2 **OF**  
3 **EDWARD J. GRUBB**

4  
5 (Docket 04-0595)

6 **WITNESS IDENTIFICATION AND BACKGROUND**

7 **Q 1. Please state your name and business address.**

8 A. My name is Edward J. Grubb.

9 **Q 2. Please state your business address, telephone number and e-mail address.**

10 A. My business address is 535 N. New Ballas Road, St. Louis, Missouri 63141. My  
11 telephone number is (314) 996-2363. My e-mail address is egrubb@mawc.com.

12 **Q 3. By whom are you employed and in what capacity?**

13 A. I am employed by American Water Works Service Company, Inc. ("AWWSC") as  
14 Manager Rates and Regulation. I am also the Assistant Treasurer of Illinois-American Water  
15 Company ("IAWC").

16 **Q 4. Please discuss your educational and business background.**

17 A. Marked as Exhibit "A" and attached hereto is a description of my education, professional  
18 experience, and training; and my current job duties.

19 **PURPOSE OF TESTIMONY**

20 **Q 5. What is the purpose of your testimony in this proceeding?**

21 A. The purpose of my testimony in this proceeding is to discuss the services agreement  
22 ("Services Agreement" or "Agreement") between Illinois-American Water Company  
23 ("Illinois-American") and American Water Works Service Company, Inc. ("AWWSC"), which is  
24 marked for identification as Illinois-American Exhibit "B."

25 **BACKGROUND**

26 **Q 6. Please describe Illinois-American.**

27 A. Illinois-American is an Illinois corporation with its principal office at 100 North Water  
28 Works Drive, Belleville, Illinois 62223. Illinois-American is engaged in the business of  
29 furnishing potable water service and sanitary sewer service to the public in portions of  
30 Alexander, Champaign, Cook, Douglas, DuPage, Grundy, Jersey, Kane, Kendall, LaSalle,  
31 Livingston, Logan, Madison, McHenry, Monroe, Peoria, St. Clair, Tazewell, Whiteside, and Will  
32 Counties, Illinois, as it is duly authorized to do, and is a public utility within the meaning of  
33 Section 3-105 of the Act. Illinois-American is the result of the prior mergers of Alton Water  
34 Company, the Cairo Water Company, East St. Louis and Interurban Water Company, Pekin  
35 Water Works Company, Peoria Water Company, and Northern Illinois Water Corporation, as  
36 approved by the Commission in Docket numbers 81-0727, 84-0204, and 99-0418; the acquisition  
37 of United Water Illinois' assets, as approved by the Commission in Docket No. 99-0457; and the  
38 acquisition of Citizens Utilities Company of Illinois' water and wastewater assets, as approved  
39 by the Commission in Docket No. 00-0476.

40 **Q 7. Please describe American Water Works Service Company, Inc.**

41 A. American Water Works Service Company, Inc. ("AWWSC"), is a corporation organized  
42 and existing under the laws of Delaware. AWWSC provides certain administrative and  
43 professional services to regulated water companies that are owned by American Water Works  
44 Company, Inc. (AW), and certain non-regulated companies affiliated and non-affiliated with  
45 Illinois-American and AWWSC. AWWSC is authorized to do business in Illinois.

**Q 8. Are Illinois-American and AWWSC affiliated?**

A. Yes. Illinois-American and AWWSC are affiliates. Illinois-American and AWWSC are both subsidiaries of AW. Illinois-American is a part of the AW Central Region that has its headquarters in St. Louis, Missouri.

**Q 9. Would you discuss the circumstances that led to the filing of this proceeding for re-approval of the Services Agreement?**

A. Yes. The Services Agreement was approved by the Illinois Commerce Commission (the "Commission"), after hearing, in Docket 88-0303. In its most recent general rate order, Docket No. 02-0690, Illinois-American was directed to re-file all of its affiliated interest agreements, including the Services Agreement.

**THE SERVICES AGREEMENT**

**Q 10. Please further discuss the Services Agreement.**

A. On January 1, 1989, Illinois-American and AWWSC entered into the Agreement, pursuant to which AWWSC provides, at cost, certain administrative and professional services to Illinois-American. Currently, AWWSC employees in the Central Region, as well as those in AWWSC's offices in New Jersey and Pennsylvania and at AWWSC's nationwide call center in Alton, Illinois, and national laboratory in Belleville, Illinois, provide the administrative and professional services contemplated by the Agreement. As noted above, a copy of the Agreement is attached hereto as IAWC Exhibit "B."

**Q 11. Would you further discuss the services provided by AWWSC under the Services Agreement?**

A. AWWSC provides the following services to Illinois-American: Accounting, Administration, Communication, Corporate Secretarial, Customer Accounting, Engineering, Financial, Human Resources, Information Technology ("IT"), Legal, Operation, Procurement,

Rates and Revenue, Risk Management, Security, Water Quality and other services agreed upon. These services are performed by AWWSC personnel, most of whom have years of water industry experience. AWWSC personnel are able to specialize in their functional areas, provide expert services, and develop a strong understanding of water quality and the business needs of each company they serve. This arrangement allows operating companies to receive high quality services at a lower cost as compared to the cost of hiring their own full-time staff. By utilizing AWWSC, Illinois-American reduces its cost of service through expanded buying power for goods and services and economies of scale associated with AWWSC's laboratory facilities in Belleville, the National Call Center, IT centers, Shared Services Center and other AWWSC infrastructure services.

**Q 12. How are costs associated with services performed by AWWSC for Illinois-American assigned to Illinois-American Water Company?**

A. Costs associated with services provided by AWWSC (including overheads as described in the Agreement) are charged to Illinois-American in accordance with provisions of the Agreement. AWWSC expenses that benefit Illinois-American's operations are charged directly or, when no direct charge to Illinois-American is possible, allocated to Illinois-American. A direct charge to Illinois-American occurs when AWWSC performs work solely on behalf of Illinois-American. Direct charge examples include work in support of an Illinois-American rate case, engineering design work for an Illinois-American project, or preparation of Illinois-American's financial statements. AWWSC expenses are allocated to Illinois-American when more than one regulated operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations that affect multiple regulated operating companies, development of the system-wide materials procurement contracts or creation of system-wide engineering design standards. As required by the Agreement, the basis

for allocating AWWSC expenses among regulated operating companies is the relative number of customers served by each benefiting company.

**Q 13. Does the Agreement permit AWWSC to perform services for entities that are not regulated operating water companies?**

A. Yes. Under the Agreement, however, no cost associated with services performed for a non-regulated entity may be charged to Illinois-American. Accordingly, all costs associated with services performed for non-regulated entities are assigned (direct or allocated) to such entities. AWWSC thereby eliminates the cost related to service performed for non-regulated entities from the balance of costs assigned (direct or allocated) to Illinois-American.

**Q 14. Does the process you describe fairly allocate costs incurred by AWWSC?**

A. Yes. As required by the Agreement, all costs that can be identified as being related exclusively to an individual company are charged directly. The importance of using direct assignment whenever possible is regularly emphasized to AWWSC employees by supervisors, who also review the employees' time reports. Also, as noted above, costs incurred for Illinois-American and one or more other regulated water companies are allocated on the basis of relative customer count. Among regulated affiliates, number of customers is an appropriate allocation method because it results in a consistent financial impact on ratepayers. The method ensures that the cost per customer for a given service is the same from one state (or rate area) to the next. For instance, when the cost to AWWSC for developing new treatment facility operating standards is allocated on the basis of customers, the method results in the same cost per customer in Illinois and in Missouri. If another allocation method were used, such as net plant in service, the cost per customer could be different in the two states. This would be unfair because each customer should generally derive the equivalent benefits from such a service irrespective of their state of residence.

**Q 15. Does Illinois-American have the ability to determine whether or not it should utilize services provided by AWWSC?**

A. Yes. Illinois-American is not required to obtain services from AWWSC. The Services Agreement provides Illinois-American with the right, but not the obligation, to obtain services from AWWSC at cost. Under the Agreement, Illinois-American has the option to utilize services provided at cost by AWWSC or, at its option, Illinois-American may either perform such services itself or obtain services from a non-affiliated vendor. In determining whether to use AWWSC services, Illinois-American considers relevant factors, such as service quality, cost-effectiveness, timeliness, reliability and adequacy of alternative suppliers. Illinois-American would not utilize services provided by AWWSC if it determines that comparable services are available at a lower cost from another source or can be performed at a lower cost with its own workforce.

**Q 16. How does Illinois-American exercise control over charges from AWWSC?**

A. There are several ways by which Illinois-American exercises control over Service Company services and charges. The most important of these are described below.

- Regional Managing Director Oversight – The Regional Managing Director of the Central Region, who is Illinois-American's President, is a member of American Water's senior management. The Regional Managing Director is responsible for the financial and operational performance of each company in the region, including Illinois-American. As part of senior management, the Regional Managing Director has input and responsibility for major business decisions of American Water and has the ability to monitor AWWSC service quality and the cost incurred by Illinois-American for services provided by AWWSC.
- Operating Company Board Oversight – Illinois-American's Board of Directors includes members of American Water's senior management. This helps ensure that the level and type of services provided are consistent with Illinois-American's needs.
- AWWSC Budget Review/Approval – The Regional Managing Director, as a member of the Board of Directors of AWWSC, must formally approve the budget for AWWSC charges for the next year. These budgeted charges are consolidated with Illinois-American's own spending into an overall budget which must be approved by Illinois-American's Board of Directors.

148 • Major Project Review And Approval – Major projects undertaken by the AWWSC are being  
149 reviewed by the companies that will pay for the initiatives. Executives authorized to perform  
150 this review include the Regional Managing Director.

151 • AWWSC Bill Scrutiny – Operating company personnel and officers of Illinois-American  
152 review the monthly AWWSC bill for accuracy, reasonableness and variances from budget.

153 **Q 17. Are the terms in the provisions of the Services Agreement in the opinion of**  
154 **Illinois-American just, reasonable, and in the public interest?**

155 A. Yes. In the opinion and judgment of Illinois-American, the terms and provisions of the  
156 Agreement are fair and reasonable and in the best interest of Illinois-American and its customers,  
157 and otherwise are in the public interest. AWWSC provides services for Illinois-American at  
158 cost, and the quality of those services is very high and tailored specifically to water utilities and  
159 their customers. These costs also have the benefit of only being incurred when needed (variable  
160 cost), similar to a third party outsourced vendor. Yet unlike a third party vendor, AWWSC does  
161 not charge a profit and is solely focused on the water industry.

162 **OTHER AGREEMENTS**

163 **Q 18. Has Illinois-American entered into other agreements regarding the provision of**  
164 **services for affiliated companies?**

165 A. Yes. In Docket No. 01-0418, a sub-agreement to the Agreement ("Sub-Agreement") was  
166 approved pursuant to which Illinois-American provided administrative and professional services  
167 to Iowa-American Water Company ("Iowa-American"). Iowa-American is also a subsidiary of  
168 AW and an affiliate of Illinois-American. Also, in Docket No. 00-0476, the Commission  
169 approved the assumption by Illinois-American of a Citizens Utilities Company of Illinois'  
170 ("CUCI") position under a services agreement (the "Citizens Services Agreement") between  
171 CUCI and Citizens Lake Water Company ("CLWC"), as a part of Illinois-American's acquisition  
172 of CUCI's water and waste water assets. Pursuant to the Citizens Services Agreement, CUCI  
173 provided administrative and professional services to CLWC and leased a portion of its office

174 space to CLWC. The stock of CLWC was acquired by AW at the same time as the water and  
175 waste water assets of CUCI were acquired by Illinois-American, thereby making the assumed  
176 Citizens Services Agreement an affiliated agreement for which approval was obtained in Docket  
177 No. 00-0476. At that same time, AW changed the name of CLWC to American Lake Water  
178 Company ("ALWC").

179 **Q 19. Are services still provided under the agreements you referenced between**  
180 **Illinois-American and Iowa-American, or the agreement between Illinois-American and**  
181 **ALWC?**

182 A. No. In 2004, AW reorganized its subsidiaries and the employees who performed services  
183 for both Illinois-American and Iowa-American and/or ALWC became employees of AWWSC so  
184 that the costs formerly allocated under the Sub-Agreement and the Citizens Services Agreement  
185 are allocated in accordance with the Services Agreement which is the subject of this docket. As  
186 a result, the Sub-Agreement and the Citizens Services Agreement have been terminated. Thus,  
187 neither the Sub-Agreement nor the Citizens Services Agreement has been re-filed with the  
188 Commission for approval pursuant to the Order issued in Docket No. 02-0690.

189 **Q 20. Does that conclude your testimony?**

190 A. Yes, it does.



**ILLINOIS-AMERICAN WATER COMPANY**

**Direct Testimony**

**of**

**EDWARD J. GRUBB  
(DOCKET 04-0595)**

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